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SUBJECT: KAZAKHSTAN: AES LOSES SUPREME COURT APPEAL

REF: ASTANA 02086

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY. AES Country Manager Mike Jonagan informed the Ambassador on November 4 that AES lost its final appeal to the Kazakhstan Supreme Court on charges of engaging in profiteering and monopoly behavior. AES will send a "trigger letter" to the Government of Kazakhstan in the next few weeks announcing their decision to go to international arbitration, based on alleged violations of the bilateral investment treaty between the United States and Kazakhstan. Jonagan asked the Ambassador to raise the issue with Prime Minister Masimov in order to avoid government pressure on the company or its employees while the arbitration case is pending. He expects AES will lose a second case pending before the courts. END SUMMARY.

A SURPRISE RULING FROM THE SUPREME COURT

13. (SBU) AES Country Manager Mike Jonagan informed the Ambassador on November 4 that AES last week lost its final appeal before the Kazakhstan Supreme Court on charges that it abused its market power by charging customers exorbitant prices for energy and hiding the excess profits. He said the ruling came as a surprise, since the Ministry of Justice gave the company "strong hints" over a period of several months that they could expect a positive decision from the Court (see reftel).

INTERNATIONAL ARBITRATION "THE ONLY REMAINING OPTION"

14. (SBU) Jonagan said that AES has now exhausted all of its legal options in Kazakhstan to resolve the case and he is "99% certain" that AES will open an international arbitration case in the next few weeks. AES plans to send a trigger letter to Prime Minister Masimov to inform him of AES's decision to go to arbitration. The letter will include a request that the Government of Kazakhstan not put any pressure on the company or its employees while the case is pending. Jonagan indicated that AES would also send "a softer letter" to

President Nazarbayev to explain the company's decision and stress their long-term plans to remain strategic investors in Kazakhstan.

15. (SBU) Once the letter is sent, both sides will identify a mediator to act on their behalf during a 60-day "cooling-off" period. The parties could settle their dispute at any time before the international arbitration panel convenes. AES is in no hurry to start the arbitration process, but they are eager to initiate proceedings before a criminal case is opened. According to AES, the Government of Kazakhstan has respected previous international arbitration rulings, most recently when they paid a settlement to AES in January.

SAMRUK INTERESTED IN HYDRO CONCESSIONS

16. (SBU) Two days before the Supreme Court found against AES, Jonagan said he met with representatives of Samruk (Kazakhstan's principal state assets holding company), who had been asked by the Ministry of Finance to help resolve the ongoing dispute. According to Jonagan, Samruk expressed strong interest in the two hydropower concessions owned by AES and suggested that AES "think about how much the hydros are worth, including the court costs and damages." That was the first indication that AES had that the Supreme Court decision was not going to go their way. Jonagan said that AES is willing to consider signing the concessions, which have nine years left to run, over to Samruk, but he indicated that the two sides are currently "about \$200 million apart" on price. Jonagan also noted that Samruk has become more assertive since Timur Kulibayev was named deputy chairman of the newly merged Samruk-Kazyna National Development Fund last month.

ASTANA 00002177 002 OF 002

AES EXPECTS TO LOSE SECOND CASE TOO

17. (SBU) AES has another case pending before the Kazakhstani courts stemming from the activities of its former trading company, which the government claims pocketed \$140 million in excess profit. AES maintains that \$140 million was the total amount of revenue generated and that the profit was only \$10 million. Jonagan said AES expects to lose this case as well, which would require immediate payment of a \$140 million fine. The former AES trading company is currently dormant, with no employees and a frozen bank account containing \$6 million. Once the financial police discover that the trading company does not have the remaining \$134 million, Jonagan said they are likely to initiate criminal proceedings against individual officers of AES. Jonagan said he is "very concerned" for the safety of their local accountant, who would be especially vulnerable to intimidation. If that were to happen, Jonagan warned, "We would go nuclear. We already have articles drafted that would run in the Financial Times to shame the government into a fair fight."

FINANCIAL POLICE QUESTION JONAGAN

18. (SBU) Jonagan said that he had no fear for his own safety, nor did he have plans to leave the country, but he did tell the Ambassador that he was "interrogated for three hours late at night last week." Jonagan thinks the financial police were investigating an unrelated matter having to do with AES's decision not to offer preferential tariffs on electricity provided to a retail company in the northern Kazakhstan city of Kostanai. He believes the company has ties to Deputy Prime Minister Shukayev.

19. (SBU) COMMENT: AES is reluctant to go to international arbitration, but they are clearly determined to fight the government's charges, which they perceive as a direct attack on their reputation and integrity. They understand that going to arbitration may adversely affect their ability to do business in the region in the future, but the company feels it has no viable options left and is unwilling to part with valuable hydropower assets it has developed and managed successfully for several years. END COMMENT.

HOAGLAND